FOR ARGUMENT

Supreme Court, U.S.
FILED
JAN 5 1980
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,

Petitioner,

vs.

COUNTY OF LOS ANGELES AND CITY OF COMPTON,

Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

PETITIONER'S REPLY BRIEF.

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
1600 One Wilshire Building,
Los Angeles, Calif. 90017,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone 724-6622

SUBJECT INDEX

Page

Preliminary Statement 1

I

The Preference Shown by California's Property Tax Law to Foreign Goods Does Not Violate the Commerce Clause 2

A. Section 225 Should Not Be Invalidated Under the Commerce Clause Since It Does Not Have a Significant Adverse Effect Upon the Federal Government's Power to Regulate Foreign Commerce 3

B. The Cases Relied Upon by Respondents Are Inapposite 6

II

Section 225 Does Not Operate to Offset Tariffs 8

A. Section 225 Preserves the Amount of Tariff Protection in Effect for Domestic Goods 8

B. The Laws of Each of Numerous Other States Create the Same Effect Respondents Claim Should Invalidate Section 225 9

C. The Interaction of the States' Diverse Property Tax Laws Inevitably Creates the Same Effect of Which Respondents Complain 10

III

Although Respondents Assert That Section 225 Is Discriminatory and Unconstitutional, the Statute Has No Apparent Effect Upon Commerce 12

Conclusion 14

TABLE OF AUTHORITIES CITED

Cases — Page

Baldwin v. G.A.F. Seelig, Inc., 294 U.S. 511 (1935) 7, 8

Bob-Lo Excursion Co. v. Michigan, 333 U.S. 28 (1947) 4

Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977) 1, 4, 6, 8, 13

Clark v. Allen, 331 U.S. 503 (1947) 5

Cooley v. Board of Wardens of Port of Philadelphia, 53 U.S. (12 How.) 299 (1852) 3

Forster Shipbuilding Co. v. County of Los Angeles, 54 Cal.2d 450, 6 Cal.Rptr. 24 (1960) 2

H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949) 7, 8

Japan Line, Ltd. v. County of Los Angeles, 60 L.Ed.2d 336 (1979) 5, 6

Michelin Tire Corp. v. Wages, 423 U.S. 276 (1976) 3, 4, 8, 9

Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978) 12

Philadelphia v. New Jersey, 437 U.S. 617 (1978) .. 13

Pike v. Bruce Church, Inc., 397 U.S. 137 (1970) 7, 8, 13

Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978) 4

Skinker, Estate of, 47 Cal.2d 290, 303 P.2d 745 (1956) 2

Page

Stanford's Estate, In Re, 126 Cal. 112, 58 Pac. 462 (1899) 2

Texas Co. v. County of Los Angeles, 52 Cal.2d 55, 338 P.2d 440 (1959) 2

Zee Toys, Inc. v. County of Los Angeles, 85 Cal. App.3d 763, 149 Cal.Rptr. 750 (1978) 12, 13

Zschernig v. Miller, 389 U.S. 429 (1968) 5

Statutes

California Constitution, Art. XVI, Sec. 6 2

California Revenue and Taxation Code, Sec. 225 ..... 3, 4, 5, 6, 8, 9, 10, 11, 12, 13

IN THE

Supreme Court of the United States

October Term, 1979
No. 78-1577

SEARS, ROEBUCK AND CO., a corporation,
Petitioner,

vs.

COUNTY OF LOS ANGELES AND CITY OF COMPTON,
Respondents.

On Writ of Certiorari to the Court of Appeal of the State of California, Second Appellate District.

PETITIONER'S REPLY BRIEF.

Preliminary Statement.

Respondents' Brief (hereinafter "Res. Br.") constitutes an aggregate of numerous disparate assertions. Many of these assertions are unsupported and many distort the decisions of this Court, particularly *Boston Stock Exchange v. State Tax Commission,* 429 U.S. 318 (1977). Some of the assertions are irrelevant and others grossly misstate Petitioner's position. Petitioner will not attempt to discuss all of Respondents' claims, but instead will focus upon the principal areas of controversy.

Respondents point out, as Petitioner did in its brief (Pet. Br. 5), that effective with the 1980 tax year California has exempted all inventories from property

tax. Respondents also note that a bill has been introduced to refund prior years' taxes which are at issue under the statute in question (Res. Br. 3-4).

A provision of the California Constitution, Article XVI, Sec. 6, prohibits the legislature from making gifts of public money. In a long line of cases commencing with *In Re Stanford's Estate*, 126 Cal. 112, 58 Pac. 462 (1899), the California Supreme Court has held that this provision is applicable to accrued tax liabilities.[1] Thus, if the taxes involved herein are held valid, the legislature cannot refund them. Respondents' suggestion that the state may order a refund is erroneous.

Since the exemption of all inventories will not take effect until the 1980 tax year, the statute in question will remain in effect for four taxable years—1976, 1977, 1978 and 1979. The resolution of this case is thus of importance to many California taxpayers. But of much greater importance is the fact that this case involves novel questions of constitutional interpretation, the resolution of which may eventually be of great importance to each of the fifty states and is presently of substantial importance to some thirty-six states having free port laws.

I

The Preference Shown by California's Property Tax Law to Foreign Goods Does Not Violate the Commerce Clause.

The main thrust of Respondents' argument is that California's tax exemption for imported goods sold in

[1] *Estate of Skinker*, 47 Cal.2d 290, 296, 303 P.2d 745, 748 (1956); *Texas Co. v. County of Los Angeles*, 52 Cal.2d 55, 338 P.2d 440 (1959); *Forster Shipbuilding Co. v. County of Los Angeles*, 54 Cal.2d 450, 6 Cal.Rptr. 24 (1960).

other states impermissibly touches upon foreign commerce (Res. Br. 32 *et seq.*). However, cases decided by this Court, including some of those relied upon by Respondents, have recognized that a state statute that does not interfere with federal policy and does not have a significant adverse impact upon federal power to regulate foreign commerce will not be held to violate the Commerce Clause. Exclusive federal regulation is mandated only where uniform national treatment of an aspect of commerce is required.

A. Section 225 Should Not Be Invalidated Under the Commerce Clause Since It Does Not Have a Significant Adverse Effect Upon the Federal Government's Power to Regulate Foreign Commerce.

Prior to the decision in *Michelin Tire Corp. v. Wages*, 423 U.S. 276 (1976), state property tax laws could have virtually no effect upon foreign commerce inasmuch as imports still in their original packages were wholly immune from state property taxation. By abolishing the original package doctrine and approving state property taxes on imported goods, *Michelin* made it inevitable that the different state property tax laws would have differing impacts upon imported goods. *Michelin* thus indicates that state property taxation of foreign goods at rest in the taxing jurisdiction does not necessitate a uniform national rule and is not "of such a nature as to require exclusive legislation by Congress." *Cooley v. Board of Wardens of Port of Philadelphia*, 53 U.S. (12 How.) 299, 319 (1852).

Respondents rely on certain language in the *Michelin* decision for the proposition that the Commerce Clause flatly prohibits encouragement as well as discouragement of the importation of foreign goods (Res. Br. 34-35). It is highly doubtful as a factual matter, and

there is no evidence in the record to support the argument, that Section 225 has the effect of increasing the aggregate amount of importation into the United States. If it accomplishes anything, Section 225 probably causes importers who have used California facilities in the past to remain in the state rather than relocate and divert their imports to another state having more favorable tax laws. California thus appears to be competing with other states only for a share of existing import business. Competition of this type was expressly sanctioned by the Court in *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 336-37 (1977).

Respondents have attempted to twist the *Michelin* decision holding that States *may* tax imports still in their original packages into a positive rule that States *must* tax such imports if other goods are taxed. *Michelin* simply does not require such taxation.

Even where a state statute has some impact on foreign commerce, it will not be invalidated absent an examination of the federal interest involved and the degree of state interference resulting from the statute. In *Bob-Lo Excursion Co. v. Michigan*, 333 U.S. 28 (1947), a Michigan law affecting foreign commerce was upheld because it was found that no national interest or policy affecting relations with foreign nations was adversely affected. In *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978), a case heavily relied upon by Respondents, the Court rejected an assertion that a Washington statute interfered with the federal government's authority to regulate foreign commerce and conduct foreign affairs on the grounds that the statute had "insignificant international consequences." 435 U.S. at 180.

The required inquiry into the extent of any asserted interference by a state statute with federal power to regulate foreign affairs is demonstrated through a comparison of *Zschernig v. Miller*, 389 U.S. 429 (1968), a case relied upon by Respondents, with *Clark v. Allen*, 331 U.S. 503 (1947), a case Respondents have ignored. In both cases, the Court considered the constitutionality of state inheritance statutes dealing with the rights of foreign nationals to inherit property. The Court upheld the California inheritance statute at issue in *Clark v. Allen*, but struck the Oregon statute involved in *Zschernig v. Miller*.

The Court in *Zschernig* found that the Oregon statute led into minute inquiries by state courts into the administration of foreign law, the credibility of foreign diplomatic statements and other matters of speculation for the state courts. The Court in *Zschernig* contrasted *Clark v. Allen* on the grounds that in that case only an incidental or indirect effect in foreign countries resulted.

In determining whether Section 225 interferes with the federal government's power to regulate foreign commerce, it is necessary to inquire whether the California statute has a significant adverse effect that violates federal policies. As discussed at pages 18-19 of Petitioner's opening brief, the California statute fully serves the policies animating the Commerce Clause.

Respondents rely upon *Japan Line, Ltd. v. County of Los Angeles*, 60 L.Ed.2d 336 (1979), for the proposition that Section 225 impairs federal uniformity in an area where it is essential (Res. Br. 31). In determining whether the state tax statute at issue in *Japan Line* was valid, the Court scrutinized the effect of the statute to see whether it interfered with any

of the policies requiring federal control over the area of foreign commerce involved. 60 L.Ed.2d at 346-51. The Court did not invalidate the state statute simply because it touched upon foreign commerce. Rather, the statute was held unconstitutional because it created the possibility of embarrassment to this country and retaliation by foreign countries.[2]

The concerns expressed in *Japan Line* over state action in certain spheres of foreign commerce are especially absent where foreign commerce is relieved of local burdens as provided in Section 225. If anything, the California statute ameliorates the concerns expressed in *Japan Line*.

B. The Cases Relied Upon by Respondents Are Inapposite.

In Petitioner's opening brief, *Boston Stock Exchange*, was analyzed in detail (Pet. Br. 14-18). Respondents offer little of substance in response (Res. Br. 40-41). In *Boston Stock Exchange*, the Court applied classic Commerce Clause principles to preclude New York from discriminating against interstate commerce as a means of benefiting local commerce. New York attempted to use its power to tax an in-state

---

[2]Respondents have attempted to show that the United States has taken a position in this case inconsistent with its position in *Japan Line*. (*E.g.*, Res. Br. 33, 54). However, the Brief for the United States in *Japan Line* made it clear that state statutes affecting foreign commerce should be upheld unless they interfere with federal policy or adversely affect an aspect of foreign commerce that requires uniform national treatment. See Brief for the United States, *Japan Line, Ltd. v. County of Los Angeles, supra*, at 5, 7, 9 and 22. The very language quoted by Respondents from page 19 of the Brief for the United States in *Japan Line* shows that the concern of the government has been with state statutes that treat foreign commerce *disadvantageously*. Thus, the position of the United States in the instant case is entirely consistent with its position in *Japan Line*.

operation (the transfer of stock) as a means of requiring that another transaction be performed in the home state (the sale of stock).

In contrast, California's statute imposes no such coercion. The exemption does not require a taxpayer to perform other operations in California as a condition for favorable tax treatment. If imported goods in the process of transshipment are in California on the tax lien date, they are entitled to the exemption. Nothing more is required.

Respondents have relied upon numerous decisions of this Court invalidating state statutes which employed discriminatory means in order to benefit local economic interests at the expense of interstate commerce.

In *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935), a New York statute required dealers to pay minimum prices to milk producers. The Court held that the effect of the statute was to suppress competition and create an economic barrier against competition by products of other states. Applying traditional Commerce Clause analysis, the statute was invalidated.

H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949), another case relied upon by Respondents, involved New York's denial of a license to a Massachusetts milk distributor, thereby precluding the distributor from establishing a milk receiving station in New York. The Court found that the denial of the license had the effect of reducing competition and protecting local economic interests. Such a suppression of competition was held to constitute a violation of the Commerce Clause.

Likewise, in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970), an Arizona statute required that cantaloupes

grown in the state be packaged within Arizona before being shipped to other states. The Court held that the statute created an unlawful burden on interstate commerce by requiring business operations to be performed in the home state that might be more efficiently performed elsewhere.

Hood, Baldwin, and *Pike* are similar to *Boston Stock Exchange* and distinguishable from the instant case. Here, no suppression of competition results from the statute. Further, the essential element in those cases—discrimination as a method to benefit local interests and exclude outside interests—is absent here.

II
Section 225 Does Not Operate to Offset Tariffs.

Respondents argue and the Court of Appeal found that Section 225 has the effect of offsetting tariffs. (Pet. for Cert., App. at 15-16). Respondents claim that a property tax exemption limited to imported goods reduces tariffs with respect to such goods and thereby diminishes the protection intended by Congress in enacting the tariffs.

A. Section 225 Preserves the Amount of Tariff Protection in Effect for Domestic Goods.

For more than one hundred years prior to the *Michelin* decision, imported goods such as those involved in this case were immune from property tax. During this period Congress enacted the Tariff Acts referred to by Respondents and thus set the levels of tariff protection while imported goods were immune from property tax. After the *Michelin* decision, states were permitted to impose property taxes upon imported goods that had historically been immune.

By enacting Section 225, however, California by statute exempted imported goods that generally had been immune from tax under the original package doctrine. Thus, Section 225 has the effect of preserving precisely the amount of tariff protection in existence prior to the *Michelin* decision and does not offset or reduce tariffs at all. Respondents' claim that Section 225 has the effect of reducing tariffs is erroneous. Section 225 has no such effect. Domestic manufacturers receive the same protection under Section 225 as they had historically received.

Although four years have passed since the *Michelin* decision, the federal government has not adjusted tariffs to take into account the additional costs imposed upon imported goods by reason of their being taxable by the states. As Petitioner suggested in its opening brief, it is likely that Congress ignores states' tax laws in setting tariffs (Pet. Br. 22).

B. The Laws of Each of Numerous Other States Create the Same Effect Respondents Claim Should Invalidate Section 225.

In addition to California, numerous other states have enacted free port laws. Like Section 225, these laws exempt imported goods held for shipment and sale in other states. However, unlike California, most free port laws also exempt goods from other states held for shipment and sale in third states. Like California, however, such states do not extend the exemption to locally manufactured goods held for shipment and sale outside the state.

If Section 225 were held invalid because it offsets the tariff protection intended for domestic manufacturers by taxing domestic goods while exempting im-

ports, then the free port laws of the other states should be held invalid for the same reason.

Respondents also refer to the tax laws of Connecticut and a number of other states (Res. Br. 43). These laws exempt all goods brought into the state as well as goods which are manufactured in the state and shipped out of the state in either interstate or foreign commerce. Goods manufactured and sold in the state, however, are taxable. By exempting imported goods sold within the state while taxing domestic goods manufactured and sold within the state, these laws have the same effect on tariff protection which Section 225 is alleged to have. Respondents, however, concede that these statutes are constitutional notwithstanding that they have the very effect which it is claimed invalidates Section 225 (Res. Br. 43 fn 12). How can it be held that the exemption accorded imported goods by Section 225 is invalid whereas the exemption accorded imported goods by Connecticut and the other states is valid?

C. The Interaction of the States' Diverse Property Tax Laws Inevitably Creates the Same Effect of Which Respondents Complain.

The laws of some states, such as New York, completely exempt business inventories from tax. These laws are clearly constitutional regardless of the effect they may have in other states. When goods imported through such a non-taxing state are offered for sale in other states in competition with domestically manufactured goods which have been taxed, the imported goods enjoy a competitive advantage over the domestic goods. This competitive advantage is precisely of the same kind and might well be in the same amount as the advantage accorded imported goods by Section 225.

The effect of Section 225 that Respondents claim is unconstitutional is the same effect that results from the interaction of differing state property tax laws upon goods that have been shipped between states. But so long as some states exempt all inventories or tax them at low rates, while others continue to tax inventories at higher rates, goods imported through the former group for sale in competition with goods shipped through the latter group will have the same type of advantage accorded imported goods by Section 225. The effect of which Respondents complain is an inevitable concomitant of a federal system in which states have autonomy, within broad limits, to fashion their own property tax laws.[3]

The only way to eliminate the competitive advantage which imported goods may gain over domestic goods as a result of differing state property tax laws is to supplant all such laws with a uniform property tax law applicable in all states. While uniformity of state tax systems may be desirable, this Court recently pointed out that Congress is the appropriate forum for such a decision. With respect to the effect of multistate

---

[3]Section 225 may relieve importers of a cost that may be incurred in the selling of goods but there are many costs with respect to importing and selling goods and many ways a state might reduce such costs in order to enhance its attractiveness as a commercial center. For example, in order to attract international trade California might construct a modern and efficient port and finance the cost through general revenue resources rather than user fees. Such action would benefit importers since they would make a proportionately greater use of the port facility while not bearing a proportionate share of its cost. The cost savings to importers resulting from such a state project would have no less an effect on tariffs than Section 225 or numerous other state programs. The direct effect Respondents suggest Section 225 has on tariffs is nothing more than an abstract and hypothetical consequence of a cost reduction.

taxation of income, the Court has recognized that risks of duplicative taxation exist whenever states have different rules concerning division of income. *Moorman Manufacturing Co. v. Bair,* 437 U.S. 267 (1978). The Court there stated:

> ". . . Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State. The Constitution, however, is neutral with respect to the content of any uniform rule." 437 U.S. at 279.

III

Although Respondents Assert That Section 225 Is Discriminatory and Unconstitutional, the Statute Has No Apparent Effect Upon Commerce.

Respondents characterize the differential in the California property tax structure as "discrimination" or "regulation" (*E.g.,* Res. Br. 12, 20). However, unlike virtually all Commerce Clause cases involving discrimination, in which there was evidence that a party suffered an adverse impact or injury, in this case there has been no showing of injury to any party. The effects upon commerce which Respondents ascribe to Section 225 are speculative and abstract.

Having failed to prove the existence of a prohibited effect resulting from Section 225,[4] Respondents argue

[4]Respondents have improperly attempted to inject in this case a declaration from another case that there is a substantial stream of interstate commerce. (Res. Br. 24, 46, 47a). Such declaration was a part of the record in *Zee Toys, Inc. v. County of Los Angeles,* 85 Cal.App.3d 763, 149 Cal.Rptr. 750 (1978), which was consolidated for appeal purposes only with this case. The court below clearly treated the two actions as separate cases and discussed the facts involved separately. 85 Cal.App.3d at 766-69, 149 Cal.Rptr. at 752-54. All of the facts herein were stipulated by the parties, such stipulation was adopted by the trial court, and it was silent as to the existence of any effect of Section 225 upon commerce.

that it should be held unconstitutional without consideration of its effect (Res. Br. 28-30). For this proposition, Respondents rely upon cases involving discrimination in favor of local commerce and against interstate commerce. In such cases, statutes fostering local economic protectionism were said to be virtually *per se* unconstitutional. Unlike the statutes in those cases, Section 225 does not involve discrimination in favor of local commerce.

In *Philadelphia v. New Jersey,* 437 U.S. 617 (1978), the Court found that in discriminating against articles of commerce coming from outside the state in favor of articles originating within the state, New Jersey had erected a barrier against interstate commerce which had the effect of impermissibly isolating the state from the national economy.

The other cases relied upon by Respondents for the virtually *per se* test of unconstitutionality involved parochial statutes that suppressed competition by requiring business operations to be performed in the home state that could be more efficiently performed elsewhere. Such economic protectionism was the basis of the decisions in *Boston Stock Exchange, supra,* and *Pike v. Bruce Church, Inc., supra,* and it is conspicuously absent in the California tax structure. Thus, the virtually *per se* standard has no applicability in the instant case.

As pointed out in Petitioner's opening brief, it is necessary for Respondents to prove that Section 225

has an effect upon competition (Pet. Br. 26). Respondents have completely failed to address the fact that there has been no evidence that interstate and foreign goods shipped through California compete with one another in the same markets in other states.

Conclusion.

For the reasons set forth herein and in Petitioner's opening brief, the opinion of the California Court of Appeal, Second Appellate District, should be reversed.

Respectfully submitted,

FRANK M. KEESLING, Esq.,
ANDREW S. GARB, Esq.,
Attorneys for Petitioner.

THOMAS W. HENNING, Esq., and
LOEB AND LOEB,
and
ANN K. SMITH, Esq., and
JONES, HALL AND ARKY,
Of Counsel.